

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE)	
COMMISSION OF THE ENVIRONMENTAL)	
SURCHARGE MECHANISM OF KENTUCKY)	CASE NO.
POWER COMPANY FOR THE SIX-MONTH)	2014-00322
BILLING PERIOD ENDING JUNE 30, 2014)	

ORDER

On September 26, 2014, the Commission initiated a six-month review of Kentucky Power Company's ("Kentucky Power") environmental surcharge¹ as billed to customers for the six-month period January 1, 2014 to June 30, 2014.² Pursuant to KRS 278.183(3), the Commission must review, at six-month intervals, the past operations of the environmental surcharge. The Commission may, by temporary adjustment in the surcharge, disallow any surcharge amounts found not to be just and reasonable, and reconcile past surcharge collections with actual costs recoverable pursuant to KRS 278.183(1).

The Commission issued a procedural schedule on September 26, 2014 that provided for discovery and the filing of testimonies. Kentucky Power filed prepared testimony and responded to two requests for information from Commission Staff. There

¹ Kentucky Power was authorized to implement an environmental surcharge in Case No. 1996-00489, *The Application of Kentucky Power Company d/b/a American Electric Power to Assess a Surcharge Under KRS 278.183 to Recover Costs of Compliance with the Clean Air Act and Those Environmental Requirements Which Apply to Coal Combustion Waste and By-Products* (Ky. PSC May 27, 1997).

² Kentucky Power's surcharge is billed on a two-month lag. Thus, surcharge billings from January 2014 through June 2014 are based on costs incurred from November 2013 through April 2014.

were no requests for intervention in this proceeding. On January 5, 2015, Kentucky Power filed a notice that it waived a hearing in this matter and requested that this case be submitted for decision by the Commission on the record. Since there are no intervenors in this case and a hearing is not necessary in the public interest, the Commission will adjudicate this case based on the evidence of record.

SURCHARGE ADJUSTMENT

The Commission's September 26, 2014 Order initiating this case indicated that, since the period under review in this proceeding may have resulted in over- or under-recoveries, the Commission would entertain proposals to adopt one adjustment factor to net all over- or under-recoveries. Kentucky Power did not propose any additional over- or under-recovery for the review period. Having reviewed the record, the Commission finds Kentucky Power's determination that it did not have any additional over- or under-recovery for the review period to be reasonable.

Kentucky Power stated that the average residential customer's monthly usage for this review period was 1,418 kWh.³ Since Kentucky Power determined it did not have any over- or under-recovery for the review period, there will be no additional impact on an average residential customer's bill.

RATE OF RETURN

In Case No. 1996-00489, the Commission found that the debt portion of Kentucky Power's weighted average cost of capital should be reviewed and reestablished during each six-month review case, and that the rate of return on common equity would remain fixed and subject to review during the two-year environmental

³ Kentucky Power's response to Commission Staff's First Request for Information ("Staff's First Request"), Item 8.

surcharge reviews. The weighted average cost of capital constitutes the rate of return applicable to Kentucky Power's environmental compliance rate base.⁴

Kentucky Power provided the outstanding balances for its long-term debt, short-term debt, accounts receivable financing, and common equity as of April 30, 2014, the last expense month of the review period. It also provided the blended interest rates for the long-term debt, short-term debt, and accounts receivable financing as of April 30, 2014.⁵ Using this information, along with the last approved return on equity of 10.50 percent,⁶ Kentucky Power calculated a weighted average cost of capital, before income tax gross-up, of 7.52 percent.⁷ Kentucky Power also provided its updated income tax gross-up factor of 1.5754,⁸ reflecting the methodology approved in Case No. 2005-00068.⁹

The Commission has reviewed Kentucky Power's determination of its weighted average cost of capital and finds the 7.52 percent calculation to be reasonable. The Commission has also reviewed the determination of the income tax gross-up factor of 1.5754 and finds that it is consistent with the approach approved in Case No. 2005-00068. Therefore, the Commission finds that the weighted average cost of capital of

⁴ Case No. 1996-00489, *Kentucky Power Company* (Ky. PSC May 27, 1997), Final Order at 26. This weighted average cost of capital is applied only to the environmental compliance rate base associated with plant installed at Kentucky Power's Big Sandy generating units.

⁵ Kentucky Power's response to Staff's First Request, Item 3.

⁶ Case No. 2009-00459, *Application of Kentucky Power Company for a General Adjustment of Electric Rates* (Ky. PSC June 28, 2010).

⁷ Kentucky Power's response to Staff's First Request, Item 3.

⁸ *Id.*

⁹ Case No. 2005-00068, *Application of Kentucky Power Company for Approval of an Amended Compliance Plan for Purposes of Recovering Additional Costs of Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff* (Ky. PSC Sept. 7, 2005).

7.52 percent and the income tax gross-up factor of 1.5754, which produces an overall grossed-up return of 10.42 percent,¹⁰ should be used in all monthly environmental surcharge filings subsequent to the date of this Order. Since the terms of the Settlement Agreement in Case No. 2012-00578¹¹ require Kentucky Power to maintain the environmental surcharge factor at zero percent until changed by the Commission, Kentucky Power's customers will not be impacted by updating its weighted average cost of capital.

OTHER ITEMS

Two developments affecting Kentucky Power's long term operation of its environmental surcharge occurred in conjunction with the beginning of this review period. Effective December 31, 2013, Kentucky Power acquired an undivided 50 percent interest in Units 1 and 2 of the Mitchell generation station located in Moundsville, West Virginia.¹² As a result of the acquisition, Kentucky Power became responsible for its pro rata share of the Mitchell generating units' environmental expenses. Certain environmental related projects at Mitchell had previously been

¹⁰ Kentucky Power's response to Staff's First Request, Item 3.

¹¹ Case No. 2012-00578, *Application of Kentucky Power Company for (1) A Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generating Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act and Related Requirements; and (5) All Other Required Approvals and Relief* (Ky. PSC Oct. 7, 2013), Final Order, Appendix A at 6.

¹² *Id.*, Final Order at 9.

included in Kentucky Power's 2005¹³ and 2007¹⁴ Compliance Plans and related costs were being recovered through the environmental surcharge due to Kentucky Power's participation in the AEP-East Pool Agreement. Kentucky Power stated that the termination of the AEP-East Pool Agreement, on January 1, 2014, resulted in the elimination of related environmental expenses from its compliance plan. Kentucky Power has not recovered any environmental expenses incurred at Mitchell since the acquisition. Subsequently, Kentucky Power filed an amended environmental compliance plan in case 2014-00396¹⁵ to recover its share of Mitchell's environmental costs through the environmental surcharge.

Kentucky Power states that due to the termination of the AEP-East Pool Agreement, it is no longer "responsible for its proportionate share (termed Member Load Ratio) of, among other expenses, the environmental expenses associated with the AEP-East Pool Agreement member companies' generating units."¹⁶ As a result of the termination of the AEP-East Pool Agreement, Kentucky Power discontinued use of the forms and lines in the monthly environmental surcharge filing that reflected AEP-East Pool Agreement-related environmental costs. The Commission has reviewed and finds

¹³ Case No. 2005-00068, *Kentucky Power Company* (Ky. PSC Oct. 17, 2005).

¹⁴ Case No.2006-00307, *The Application of Kentucky Power Company for Approval of an Amended Compliance Plan for Purposes of Recovering Additional Costs of Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff* (Ky. PSC Jan. 24, 2007).

¹⁵ Case No. 2014-00396, *Application of Kentucky Power Company for: (1) A General Adjustment of Its Rates for Electric Service; (2) An Order Approving Its 2014 Environmental Compliance Plan; (3) An Order Approving Its Tariffs and Riders; and (4) An Order Granting all Other Required Approvals and Relief* (Ky. PSC filed Dec. 23, 2014).

¹⁶ Direct Testimony of Amy J. Elliott at 4. Participants in the AEP-East Pool Agreement were Appalachian Power Company, Kentucky Power Company, Indiana-Michigan Power Company, Ohio Power Company, and American Electric Power Service Corporation as agent.

reasonable Kentucky Power's decision to remove the AEP-East Pool Agreement-related forms from the monthly environmental surcharge reports.

IT IS THEREFORE ORDERED that:

1. Pursuant to the terms of the Settlement Agreement in Case No. 2012-00578 and the Commission's Order in Case No. 2013-00325,¹⁷ Kentucky Power's environmental surcharge billing factor will remain at zero percent until changed by the Commission.

2. Kentucky Power's determination that it had no additional over- or under-recovery for the review period is approved.

3. Kentucky Power shall use a weighted average cost of capital of 7.52 percent, an income tax gross-up factor of 1.5754, a return-on-equity rate of 10.50 percent, and an overall grossed-up return of 10.42 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

4. The charges and credits determined by Kentucky Power through its environmental surcharge for the period January 1, 2014 through June 30, 2014 are approved.

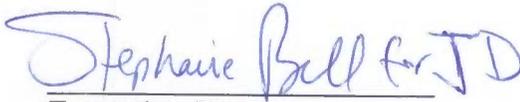
5. Kentucky Power's removal of the forms and lines that reflected AEP-East Pool Agreement-related environmental costs from the monthly environmental surcharge report is approved.

¹⁷ Case No. 2013-00325, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Two-Year Billing Period Ending June 30, 2013 (Ky. PSC Apr. 29, 2014).

By the Commission

ENTERED 
MAR 06 2015
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


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